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## Chapter 3

# Trust and Mutual Recognition in the Services

## Directive

Gareth Davies

### I. Introduction

To portray mutual recognition between States and central legislation only as alternatives is to give an overly static picture of their role and effects. In any realistic attempt at market-making they are intertwined and interdependent, and the concept of trust plays an important role in explaining the relation between them. In particular, whereas mutual recognition is usually said to require trust as a precondition, harmonizing legislation has trust as its effect, and sometimes its goal<sup>313</sup>. Yet this observation immediately shows how central legislation may in fact serve to create the conditions for decentralized mutual recognition, provided that post-legislative discretionary space remains.

Nicolaidis suggests that an important way in which legislation creates trust and promotes mutual recognition is by creating mechanisms of

1 'mutual monitoring' and 'reciprocal spying' which prevent States from  
2 'cheating',<sup>314</sup>. The core insight is that where States have knowledge of each  
3 others rules and practices they are inhibited from adopting regulation that  
4 deviates too far from accepted norms or that fundamentally undermines the  
5 interests of their partners<sup>315</sup>. To do so would risk these partners calling into  
6 questions the fundamentals of the mutual recognition system, and  
7 threatening precisely the trading profits that the State is trying to win.  
8 Incomplete harmonisation, focusing on co-ordination and transparency, may  
9 therefore serve to facilitate and stabilize mutual recognition.

10 Kerber and Van den Bergh, among others, have described the other  
11 side of the coin, how mutual recognition promotes harmonisation<sup>316</sup>. They  
12 take the view that mutual recognition creates instability, a dynamic principle  
13 one of whose major functions is to provoke the vertical reallocation of  
14 powers. They point out that mutual recognition confronts jurisdictions with  
15 each other's rules, revealing and contrasting the differences. Stable mutual  
16 recognition may emerge if the differences are unimportant. However, it is  
17 just as likely, perhaps more likely in the current state of European  
18 integration, that this confrontation will serve to highlight the need for future  
19 substantive harmonisation. In other words, the extent to which States can  
20 tolerate each other's regulation is not always clear until they try, and trying  
21 may be exactly what persuades them that harmonisation is a preferable

1 alternative to tolerance<sup>317</sup>. The resulting harmonisation may be substantive,  
2 but it may also have communicative elements, aimed at increasing  
3 knowledge of each other's rules, moving from what Nicolaidis calls 'blind  
4 trust' to what she calls 'binding trust'<sup>318</sup>. The resulting mutual recognition  
5 may then be stretched by entrepreneurial States or economic actors until it  
6 reaches the limits of the newly established trust, leading to new calls for  
7 legislative intervention, so that, as she puts it 'a new cycle then begins'<sup>319</sup>.

8       Into this context of an unstable and dynamic relationship between  
9 mutual recognition and harmonizing legislation, between the legislator and  
10 the courts, this article offers the services directive as an example of the ideas  
11 above at work. It suggests that the directive is not of great substantive  
12 import, but is primarily a communicative measure, which in turn may make  
13 the substantive rules on free movement of services – which are greatly  
14 composed of mutual recognition – effective.

**15 II. The services directive**

16 The services directive has been presented as an attempt to create a single  
17 market for services by laying down clear and far-reaching rules on free  
18 movement<sup>320</sup>. These are intended to create sufficient rights for providers,  
19 and impose sufficient constraints on public authorities, so that free  
20 movement will become a reality. Given that the continued existence of

1 diverse national standards and regulatory approaches within a single market  
2 can create problems of competition and consumer protection, the directive  
3 also contains feedback mechanisms aiming to provide a basis for future  
4 harmonisation to deal with these problems. The directive thus appears to  
5 envisage a sequential process that can be briefly summarized as (1) create  
6 the market (2) analyse the problems created (3) take the necessary  
7 compensating measures.

8       It is argued here that this is not an adequate description of how the  
9 directive will work. The primary problem of the internal market is not an  
10 absence of far-reaching free movement rules. These exist already as a result  
11 of the Treaties and the jurisprudence of the Court. Rather, the lack of free  
12 movement in practice results from a lack of motivation on the part of the  
13 States to implement these rules, a considerable room for discretion which  
14 allows States to *de facto* restrict such implementation, and an absence of any  
15 Union-level measures addressing these problems of enforcement and  
16 implementation. The rules already exist, but there is sufficient room for  
17 States to hinder their effective use, and this they do.

18       The directive does not address these enforcement and  
19 implementation issues and does not take the substantive rules on free  
20 movement much further than the current position. The directive will

1 therefore not be sufficient to directly create a single market. Its contribution  
2 to the substantive right of free movement is relatively slight.

3         Instead, the directive does something else. It provides for increased  
4 transparency in many ways, and for increased communication between  
5 national authorities in different States. This may help create trust between  
6 national authorities, and can be more specifically analysed using the theories  
7 of oligopoly and of regulatory competition. The limited number of States  
8 involved in the internal market suggests that the directive may encourage  
9 regulatory collusion. States may voluntarily converge towards consensual  
10 standards and regulatory approaches that protect each State against  
11 regulatory pressure from migrant businesses, their customers in the market  
12 for regulation.

13         It remains to be seen whether this is beneficial or not. In general,  
14 collusion enabling providers to act independently of customers is not to be  
15 welcomed, but where those providers are of laws and enjoy democratic  
16 legitimacy, whereas the customers – mobile businesses – do not, co-  
17 operation between national authorities may be a desirable counter-balance to  
18 the risks of migration-fuelled regulatory competition. Moreover, the  
19 resulting trust may lead to an increase in free movement, as States apply free  
20 movement rules more leniently and co-operatively to partner States with  
21 which they have reached a regulatory understanding.

1           In any case, oligopoly theory suggests that the services directive  
2   should be viewed in a slightly different light from the usual one in which it  
3   is presented. It appears to have a reflexive character, and to create a  
4   mechanism for convergence of rules which is unusual in being consensual,  
5   variable and dynamic, and entirely decentralized, and in which the  
6   Commission is potentially marginalized. The services directive may also  
7   turn out to be effective at creating an Internal Market, but via the creation of  
8   trust and understanding between States, rather than via the toughness of its  
9   rules on free movement.

10           The following sections elaborate on this. In turn they consider (i) the  
11   problems which a legal attempt to create a single market for services has to  
12   address; (ii) whether the directive provides an effective free movement  
13   regime, and (iii) whether its communication and information provisions will  
14   contribute to voluntary convergence, and to inter-State trust and acceptance,  
15   and thereby indirectly leads to a working single market.

**16   III.    The problems of the single market for services**

17   Insofar as the absence of a working single market for services can be  
18   attributed to legal failure, that failure can be most plausibly located in one or  
19   both of two places. On the one hand, it is arguable that the rights of free  
20   movement on which the market is based are insufficiently clear or far-

1 reaching; they do not sufficiently constitute the market. On the other hand,  
2 whether or not those rules are in principle adequate, it is arguable that States  
3 do not implement or comply with them with enough enthusiasm or good  
4 faith, and the rules are not sufficiently enforceable to overcome the obstacles  
5 that this lack of national goodwill creates. The problems can thus be divided  
6 into those of substance, and those of enforcement and implementation.

7         Sustaining both of these problems is a deeper, non-legal one, which  
8 may be called the problem of trust. States are not motivated to fully apply  
9 free movement rules, because they do not have faith that this is in their own  
10 interests, for a number of reasons. They exploit the defects of the law  
11 because they can, and because they want to. This is something that requires  
12 attention in itself.

**B**         **A.**     Inadequacies in the substantive rules

14 Under the current interpretation of the Treaty, the application of any national  
15 measure which might tend to make the cross-border provision of services or  
16 establishment less attractive, or might hinder it in any way, is in principle  
17 prohibited unless the State in question can show that the application is  
18 necessary to achieve a justified goal, and is proportionate<sup>321</sup>. A body of case  
19 law makes clear that proportionality is to be interpreted in a free-movement-  
20 friendly way, and the Court subjects national measures to strict, even



1 sceptical, scrutiny<sup>322</sup>. In the course of interpreting proportionality it has laid  
2 down a number of rules to this effect. For example, national rules must not  
3 attempt to duplicate requirements contained in home State laws<sup>323</sup>,  
4 administrative requirements on service providers must be cheap, simple, and  
5 completion may not be a pre-requisite for starting work<sup>324</sup>, and the consumer  
6 must be treated as reasonably self-sufficient, so that imposition of  
7 paternalistic standards will not be permitted<sup>325</sup>.

8 In substance, these comprise a far-reaching market manifesto, and  
9 full compliance would result in a market in which movement between States  
10 was hardly more difficult than internal movement. In fact this is a  
11 formulation that the Court has on occasion used; application of rules making  
12 cross-border movement harder than domestic is prohibited<sup>326</sup>. There is the  
13 market then; *Voilà!* If compliance could be assumed, the market would exist  
14 already.

15 However, a practical problem with the substantive law is its high  
16 degree of abstraction. What is ‘justified’ and ‘proportionate’ is open to  
17 argument, and while a distinct philosophy emerges from the case law of the  
18 Court of Justice, this is less accessible and forceful than explicit and specific  
19 rules would be<sup>327</sup>. Moreover, the Court links its decisions to the individual  
20 facts, meaning that it is always open for a Member State to argue that the  
21 facts in a subsequent case justify drawing the line in a different place<sup>328</sup>.

1 Necessity, justification and proportionality remain negotiated, ambiguous,  
2 open-textured concepts.

3 Moreover, the status of judicial interpretations as law is not self-  
4 evident in all Member States. The degree to which the Court of Justice's  
5 pronouncements should be abstracted and treated as generally binding  
6 interpretations of the Treaty – even if expressed as such is not settled  
7 decisively as a matter of doctrine<sup>329</sup>. Nor, as a matter of practice, can judicial  
8 statements be expected to have the same general impact on regulatory  
9 authorities as a written law would have.

10 To the EU specialist, the substantive law is therefore remarkably  
11 complete and powerful. The 'right' interpretation – that the Court of Justice  
12 would give in a case – is not too hard to predict, and it allocates free movers  
13 a high degree of protection against national regulatory hindrance. However,  
14 that law is not formulated in a way that will have maximum practical impact  
15 on the authorities required to apply it, and so does not fulfil its own  
16 potential.

**B. The problems of implementation and enforcement**

18 If States simply snub their noses at the law then one might speak of legal  
19 delinquency, and the solution would not necessarily lie in better rules but in  
20 enforcement mechanisms. However, there are ways of resisting full

1 application that fall short of such outright legal rebellion<sup>330</sup>. Primarily, in the  
2 context of the internal market, States may take a stance on the ambiguous  
3 concepts of necessity, justification and proportionality that is favourable to  
4 national interests or the regulatory *status quo*, and relatively unfavourable to  
5 free movement. By doing so they can effectively block free movement by  
6 continuing to apply restrictive national rules, claiming that these are  
7 genuinely necessary and justified.

8         The State might lose if the matter is appealed all the way to the Court  
9 of Justice, but this is barely relevant in practice. Firstly, commercial reality  
10 entails that service providers do not have years to spare for a protracted legal  
11 fight. Thus, in practice the initial position of a State on the legitimacy of its  
12 national laws is the one that the service provider will generally have to live  
13 with. The theoretical possibility of legal challenge, particularly given the  
14 speed of most legal systems, not to mention costs, is not a viable basis for a  
15 working free movement regime. Secondly, even if legal challenge does  
16 result in a rejection of the State's regulatory provision and a vindication of  
17 free movement, the State is still able to treat the judgment as restricted to the  
18 facts, and to continue its restrictive behaviour in other spheres.

19         Member States are therefore able to exploit the lack of clarity of the  
20 law to claim that particular restrictive measures are in fact necessary and  
21 proportionate. Debunking such conservative readings of the law requires

1 engagement with the nuances of EU law, which in reality entails an  
2 impractical level of litigation. The ambiguity of free movement law is  
3 therefore widely seen as a major reason for its limited effectiveness in  
4 practice<sup>331</sup>.

5 EU law does not address these enforcement problems . It does  
6 require that judicial protection of EU rights be ‘effective’, and the Court –  
7 and the directive – have laid down some further requirements<sup>332</sup>, but the  
8 standards resulting do not require a legal process sufficiently speedy and  
9 accessible to meet the demands of commercial reality for small to medium-  
10 sized service providers. Nor could this be so; it would amount to a  
11 revolution in domestic legal systems.

12 Most importantly, nothing in EU law makes it wrongful for a State to  
13 consistently take a conservative approach to the interpretative space that the  
14 law offers. The fact that time after time States take positions that EU law  
15 specialists consider highly unlikely to survive the scrutiny of the Court of  
16 Justice does not in itself amount to a violation of EU law, nor attract  
17 punishment or criticism from the Court of Justice or Commission. Each case  
18 is decided on its merits, and the fact that a State has fought and lost  
19 analytically similar cases in the past is not relevant to the outcome, nor even  
20 to a claim for damages, unless those cases are so similar as to be identical –  
21 which given the open texture of the law is always arguably not the case<sup>333</sup>.

1 The sanction for a wrongful standpoint is generally no more than being  
2 required to change that particular standpoint if the case is ultimately litigated  
3 and lost.

4       The fact that a State consistently takes losing legal positions on free  
5 movement is therefore merely part of the legal game. This is probably  
6 inevitable. The same applies to appeals within a domestic legal system; the  
7 fact that a judgment is overturned on appeal, or even that a court finds its  
8 judgments often overturned on appeal to the extent that it attracts a  
9 reputation as particularly conservative or radical or whatever, does not  
10 render that court or its judgments illegitimate or subject to sanctions.  
11 Respect for judicial independence is too high to permit this. A similar logic  
12 may be applied to national regulatory authorities. Moreover, the problem is  
13 not just with such authorities. National judges tend to defer to governmental  
14 assessments of necessity and proportionality<sup>334</sup>, and once again, the mere  
15 fact of being consistently wrong does not attract sanctions.

16       Given the room which the open-textured nature of free movement  
17 law leaves for interpretation there is therefore nothing in EU law to prevent  
18 national authorities and courts from consistently taking conservative and  
19 free movement-unfriendly positions with respect to the application of  
20 national rules. They are in principle obliged to follow the Court's  
21 interpretations, but are neither sanctioned nor prevented if they interpret

1 autonomously and divergently. *De facto*, EU law does not guarantee free  
2 movement rights.

3 **C. The problem of trust**

4 Although the law leaves room for States to resist free movement, this does  
5 not necessarily mean that they will choose to do so. However, the fact that a  
6 single market for services is not considered to exist suggests that to a  
7 considerable extent such resistance does occur.

8 This situation may be described by saying that States and national  
9 authorities clearly exercise their interpretative discretion in a way that  
10 favours national interests more, and free movement less, than EU law would  
11 prefer. There is obviously a perception in the States that maximizing free  
12 movement by seeking to minimise the obstacles caused by national  
13 regulation is not in fact in the national interest or in the interest of the  
14 regulatory authority in question and/or its direct clients.

15 The most obvious basis for this view is the perception that other  
16 States do not regulate adequately, or as well as the host State, so that  
17 admitting foreign service providers without subjecting them to the full range  
18 of national regulatory demands undermines quality on the local market to  
19 the detriment of local consumers. This perception is not likely to be based  
20 on a deep knowledge of foreign rules or inadequacies, but is the result of a

1 precautionary approach which in turn is probably based partly on a  
2 presumption of local superiority, and partly on the natural inertia and  
3 suspicion of non-conformity that one may attribute to institutions generally.

4       However, it is suggested that this concern for consumers is not likely  
5 to be the major motivation for restricting market access. Consumer  
6 protection is often a repackaging of concerns about unfair competition, and  
7 in these cases the primary objection to exemption from local rules for  
8 foreign economic actors is the perception that this is unfair<sup>335</sup>. This is partly  
9 based on the substantive argument that through exemption they gain a  
10 market advantage over domestic competitors, by being subject to a lesser  
11 regulatory burden, and partly based on the formal view that all should be  
12 treated identically, a view which has strong European roots and has  
13 considerable legal and philosophical capital in the Member States<sup>336</sup>. There  
14 is a resistance to the argument that because some actors are different they  
15 deserve to be treated differently. In this case that argument would suggest  
16 that those subject to the regulation of their home State deserve to  
17 consequently have a different status under the regulation of the host State,  
18 but the concept of exemptions for difference is resisted on far more general  
19 and philosophical grounds, linked to matters such as the unity of the State  
20 and the blindness of public authority to categories of citizens<sup>337</sup>.

1        Less philosophically and more practically, national authorities may  
2 resist to free movement out of concerns about where it will take them. The  
3 idea of special legal treatment for foreign-based providers entails a form of  
4 regulatory competition which is highly contested, and in fact probably  
5 rejected by most members of the European political class and the European  
6 public<sup>338</sup>. It raises the spectre of the race to the bottom, and States may resist  
7 free market access because they fear that if they are too open they will (a)  
8 encourage domestic firms to relocate abroad to low-regulation States, and  
9 (b) be participating in a game which will lead to a spiralling down of  
10 regulatory standards, not only harming national interests but also reducing  
11 national control over the quality of national markets<sup>339</sup>. Regulatory  
12 competition is a significant threat to the substantive regulatory autonomy of  
13 States, and it is hardly surprising therefore that they seek to resist forms of  
14 free movement which entail this<sup>340</sup>. Indeed, one of the issues which the law  
15 of the internal market has failed to address adequately is the fact that  
16 regulatory authorities often do not in fact appear to accept the fundamental  
17 principles upon which the internal market is based; that economic actors  
18 should be able to operate throughout the EU while only being subject to a  
19 single regulatory jurisdiction. By contrast, both governments and the public  
20 are probably more sympathetic to a ‘when in Rome do as Romans do’ rule;



1 if you want to do business in X, comply with its rules<sup>341</sup>. The justice of this  
2 is certainly easier to explain and to grasp.

3 Finally, there is the issue of reciprocity. While economists may  
4 suggest that it is beneficial to open one's markets even if partner States do  
5 not do the same, this view does not attract much political support. Given the  
6 weaknesses of the law, open markets are not beyond question, and it may be  
7 assumed that States fear that if they are too obedient to EU law for their own  
8 good they will be in the position of having their domestic markets  
9 'plundered' by foreign providers while their own providers will be unable to  
10 gain access to markets abroad. This is a situation which could be analysed in  
11 game theoretical terms. Even if States believe in open markets generally,  
12 given that they also believe in reciprocity they are unlikely to make the first  
13 move unless they have some mechanism for protecting themselves against  
14 misuse of this generosity by their neighbours. This protection could lie in the  
15 possibility to reclose markets, but a sense of protection could also arise from  
16 a mechanism for creating trust between authorities in different States.

17 The problems may be summarized by saying that there is a lack of  
18 trust in foreign standards, and a lack of faith in the concepts underlying the  
19 EU market regime and in that regime as a whole<sup>342</sup>. States do not appear to  
20 feel confident that opening their markets to non-compliant service providers  
21 from other jurisdictions will not lead to serious local economic and social

1 harm, largely because they fear that other jurisdictions do, or will, adopt low  
2 standards, and that they will be caught in the pincer between the need to  
3 prevent businesses leaving the country, and the desire to regulate in  
4 accordance with local preferences.

**5 D. Ways of addressing the legal problems**

6 Measures to increase the effectiveness of free movement law might take one  
7 of a number of forms. The most obvious would be to reduce the ambiguity  
8 which enables national resistance. This could be done by legislation spelling  
9 out the content of free movement law in a more precise and specific way. It  
10 could also be done by giving a procedural content to the assessment of  
11 necessity, justification and proportionality<sup>343</sup>. Providing lists of relevant  
12 factors and guidelines for their use would constrain national authorities and  
13 result in less deviation from the Court's preferred interpretative approach.

14 Another way of increasing effectiveness would be for EU law to  
15 directly address the procedural problems of enforcement – for example  
16 requiring extra-speedy judicial processes or appeals, or imposing a  
17 presumption of free movement rights while a case is pending. This approach  
18 is unlikely to be followed because of the degree to which it imposes on  
19 national legal systems and domestic procedure.

1           A third way is to address the issues of trust and motivation, to create  
2 a situation in which States perceive opening their markets to foreign service  
3 providers to be in their own interests, or to raise no or limited conflicts with  
4 other interests.

5           The following two sections consider the extent to which the services  
6 directive offers any solutions such as these.

7 **IV. The services directive as a regime for free movement**  
8 **and regulatory competition**

9 The directive is presented as legislation promoting free movement by  
10 enacting free movement rights. This view is unsatisfying for three reasons.  
11 Firstly, the directive barely changes the existing law. Secondly, its limited  
12 scope means that even if it is implemented in good faith it does not address a  
13 sufficient range of issues to be properly market-opening. Thirdly, there is  
14 little reason to think that its rights will be harder than those of the Treaty,  
15 since there is a continued avoidance of enforcement and implementation  
16 issues. It is true that the fact of setting rights out in legislation may  
17 encourage a fuller adoption of them than would be the case if they remained  
18 products of case law, but given the limitations of the substance of the  
19 directive this is not enough to rebut the conclusion that the directive does not

1 provide sufficient or even particularly significant legal support for free  
2 movement.

3 **E.** Does the directive take the law any further?

4 The chapter on freedom of establishment is in substance an enactment of the  
5 Court's interpretation of Article 49 TFEU.<sup>344</sup> It requires, as does the Treaty,  
6 in the view of the Court, that measures restricting access to the provision of  
7 a service as an established person must be justified by the pursuit of a  
8 legitimate interest, necessary for this, and proportionate. The chapter sets out  
9 lists of examples of measures which would be prohibited and which should  
10 be regarded with suspicion, but there is nothing in these lists which would  
11 surprise a lawyer<sup>345</sup>. The prohibited measures are ones that have long been  
12 prohibited as a result of judgments of the Court. The doubtful ones are to be  
13 assessed in the light of the principles of justification and proportionality  
14 again.

15 Thus while the codification of the case law may have a certain  
16 clarificatory value, this should not be overstated. The codification has been  
17 done in a relatively banal way, with the most obvious points being spelt out,  
18 but the more difficult points – what exactly is necessary and/or  
19 proportionate? – continuing to be left open. The room for interpretation,

1 dispute, and *de facto* restriction of movement is therefore little changed from  
2 what it was before the directive<sup>346</sup>.

3       The services chapter has attracted attention for its appearance of  
4 progress. While no longer referring to the country of origin principle, it  
5 essentially maintains it in substance. It restricts the application of host State  
6 service rules to foreign providers to such an extent that they are in principle,  
7 within the sphere of the directive, almost as good as exclusively regulated by  
8 their home State. Host State rules can only be applied where justified by  
9 public policy, security, health or the environment, and the probability is,  
10 given the way these concepts have been interpreted in the past, that they will  
11 continue to be strictly enough interpreted that one may speak of exceptional  
12 derogations from the general rule of exclusive home State control.

13       Yet, alongside this far-reaching general idea a number of provisos  
14 must be placed. Not least is the fact that the difference between the country  
15 of origin principle and the existing Treaty rules interpreted into Article 56  
16 TFEU is not so great. Currently Member States are entitled to apply national  
17 measures to foreign service providers wherever justified, necessary and  
18 proportionate, which seems open-ended, but in practice the Court has been  
19 restrictive, and the litigation success rate of States is low. While, for  
20 example, consumer protection is often cited as a reason for restricting  
21 market access which the services directive takes away, there are few cases in

1 which it has actually been successfully relied upon<sup>347</sup>. Thus the legal  
2 principle contained in the directive is really very close in practice to the  
3 legal principle found in the existing case law – the more extensive  
4 derogations from free movement which are presently permitted tend to be  
5 unsuccessful anyway<sup>348</sup>.

6 Nevertheless, the fact that these cases on consumer protection were  
7 brought indicates that the open-ended justifications which the case law  
8 permits provided an opportunity for conservatism on the part of States.  
9 Given that, as it has been argued above that the commercial disadvantages of  
10 litigation often give States effective ownership of open-ended concepts,  
11 removing some of those concepts is likely to aid free movement. However,  
12 this is mitigated by the fact that as a result of narrowing the category of  
13 exemptions to free movement, the ones that remain are likely to become  
14 more contested. If public policy remains the only justification for derogation  
15 then we will probably see States straining to expand this concept and  
16 bringing ever more arguments within it<sup>349</sup>. Since the limits and definitions of  
17 public policy are as potentially open-textured as any others – ‘sufficiently  
18 serious threat to a fundamental interest of society, ‘interpreted strictly’,  
19 ‘proportionate’ (...)’<sup>350</sup> – the challenge of preventing national authorities  
20 from misusing interpretative spaces for an over-restrictive approach to free  
21 movement has not been met.

1           A criticism of both the establishment and services chapter is that they  
2 only appear to apply to a limited class of public measures: those restricting  
3 ‘access to a service activity’<sup>351</sup>. This may be contrasted with the broader  
4 Treaty prohibition which, in the eyes of the Court, covers ‘any measure  
5 which may hinder or make less attractive’ the exercise of free movement<sup>352</sup>.  
6 The distinction lies in measures which do not directly concern access to a  
7 service activity as such, but do in fact make it harder to provide services  
8 abroad. These could be aspects of planning rules, the legal system, vehicle  
9 and property use, the integration of the family of the service providers, and  
10 tax issues, to which the directive will not apply. Given that services are  
11 provided by people or organisations which must exist as people or  
12 organisations, as well as engaging in their service activity *pur sang*, the  
13 directive is not wide enough in scope to function as a real market opener<sup>353</sup>.  
14 It does not even pretend to address the full range of legal factors which in  
15 fact make it harder to supply services abroad. As a result, service providers  
16 will often have to fall back on the Treaty articles to establish the legal rights  
17 necessary for their activities, an undesirably messy legislative position<sup>354</sup>.

18 **F.    Enforcement and implementation again**

19 Although the directive does not substantially develop the substantive law,  
20 and is even narrower than the Treaty in some ways, it may stimulate national  
21 authorities to take account of free movement rights simply by virtue of being

1 a directive, explicitly addressed to them<sup>355</sup>. Commanding the attention of the  
2 national regulator is a useful, if insufficient, step in enforcing the law.

3       The administrative provisions of the directive may also help with  
4 practical enforceability. These require States to make the administrative  
5 procedures associated with access to a service activity ‘sufficiently simple’,  
6 and accessible via a single point of contact, which must include an online  
7 contact point<sup>356</sup>. This should make it easier for service providers to establish  
8 what their legal position is, and encourage them to assert rights. An assertive  
9 approach is more probable where providers have a clear line of  
10 communication with the authorities, and do not feel lost in a sea of  
11 bureaucracy.

12       Nevertheless, these are rearguard arguments. Neither the mere fact of  
13 being written law, nor the simplification of the bureaucracy associated with  
14 cross-border movement address directly the continued weaknesses and  
15 ambiguities of the substantive law. It is difficult to believe that the delays  
16 and difficulties associated with dealing with local authorities are in  
17 themselves a significant enough obstacle to movement that addressing them  
18 in this procedural way will fundamentally change the level of market  
19 integration.



**V. The services directive as a mechanism for inter-state  
co-operation**

The services directive may not provide adequate free movement rights directly, but it does create mechanisms through which Member States can communicate with each other about issues and concerns relevant to service activities<sup>357</sup>. Looking at these mechanisms in the light of theories about competition suggests they may be effective in helping create inter-State consensus over levels and types of regulation and in helping States accept each others' rules and service providers. The directive may therefore contribute to free movement via an indirect – second order – mechanism. It can be seen as a type of reflexive law, encouraging States to react constructively to each other and converge voluntarily and flexibly<sup>358</sup>.

**G. A regulatory oligopoly**

The starting point for this perspective is a view of Member States as sellers on a market for regulation; each State offers its rules and hopes that this will attract and stimulate economic actors, who will use the State as a base for their service provision throughout the EU<sup>359</sup>. This is often described in terms of regulatory competition, and it is the fear of many that such competition between States may lead to a race to the bottom<sup>360</sup>. Precisely, the hard free movement rights to which the directive is often presented as containing raise

1 this risk, because they make it possible for companies to choose their State  
2 of establishment independently of the location of their customers.

3         However, not all markets function perfectly, and the market for  
4 regulation within the EU has some of the characteristics of an oligopoly – a  
5 relatively small number of providers dominate the market. In this case, the  
6 number of providers of regulation has a ceiling of the number of EU  
7 Member States.

8         In oligopolistic markets the risk arises that the providers either  
9 collude – form a conscious cartel – or that they engage in non-collusive  
10 parallel behaviour – they converge in products and prices even without  
11 explicit agreement to do so<sup>361</sup>. The result of either path may be that the  
12 providers collectively take on the characteristics of a dominant market actor,  
13 able to act to a significant extent independently of consumers – who are in  
14 this case the service providers subject to the regulation<sup>362</sup>. The risk of  
15 regulatory competition, by contrast, is that States become enslaved to  
16 migrating companies, who can dictate the terms of regulation<sup>363</sup>. The reply  
17 in terms of oligopoly is that by collusion or natural parallel behaviour States  
18 may once again assert their independence of those companies, and be able to  
19 act in their own interests – or those of their voters.

20         However, such oligopolistic parallelism does not happen in all  
21 markets. A number of factors make it more or less likely<sup>364</sup>. The first of

1 these is the number of sellers in the market, and on the whole a smaller  
2 group is more likely to act as one than a larger group. The number of  
3 Member States in the EU, currently 27, is on the high side for either  
4 collusion or parallelism. However, for many kinds of service the EU may  
5 not be one market. For reasons of infrastructure, language, the availability of  
6 staff, physical location, among other issues, not every jurisdiction will be  
7 able to plausibly compete for the headquarters of all service providers. Thus  
8 for any given service in any given part of the EU there may be a smaller  
9 number of jurisdictions that are realistic options for establishment, and that  
10 are therefore in competition with each other. The EU may in fact consist of  
11 multiple smaller overlapping services markets.

12 A second factor which is considered to make collusion or parallel  
13 behaviour much more likely is the availability of information about what  
14 competitors are doing. It is sometimes possible for parallel behaviour to  
15 occur entirely without contact between firms if one makes clear pricing and  
16 policy announcements, and so behaves as leader for the others, who  
17 understand implicitly and independently that it is in their interests to follow  
18 the leader rather than undercut it. If there is contact between market actors  
19 this increases further the chance of non-competition.

20 A large part of the services directive is devoted to increasing  
21 transparency and making information about regulatory demands available<sup>365</sup>.

1 The administrative chapter is aimed at making requirements clear for service  
2 providers<sup>366</sup>, but if the information is ‘out there’ on clear websites, as is the  
3 intention, it will be equally available to the authorities of other States. It  
4 seems plausible that at the moment most national authorities have relatively  
5 little knowledge of the details of regulatory requirements of other States, and  
6 the publication of the details to providers will also raise the level of  
7 information available to sister-authorities significantly. Additionally, the  
8 directive contains provisions requiring communications networks to be set  
9 up between national regulatory and supervisory authorities<sup>367</sup>. This is  
10 expressed to be primarily for the purpose of assisting each other with the  
11 supervision of specific providers, and exchanging information about  
12 reputability and so on. However, the fact that channels of communication  
13 are being created and kept open is likely to lead to an enhanced  
14 understanding of each other’s regulatory content, methods, and philosophy  
15 in general, as well as of plans for changes and developments. Almost  
16 inevitably, the creation of this network will be the beginning – or in some  
17 cases further development – of a conversation between regulatory  
18 authorities.

19 The third of the major factors determining the behaviour of  
20 oligopolists is the possibility to sanction members who depart from the  
21 terms of (implicit) agreements. The cartel that can sanction its members is

[illegible]

1 State is effectively engaged in negotiating market access with its fellow  
2 member States.

3 The sanction is then that a State<sup>s</sup> which chooses to go its own  
4 regulatory way, without concern for the consensus of other States, may find  
5 that its providers have difficulty operating in other States. This need not be  
6 as a result of any conscious retribution. However, if there is a regulatory  
7 consensus about the proper level of protection or types of acceptable  
8 constraint, then a State will feel more confident and justified in interpreting  
9 e.g. public policy, justification or proportionality in a way that excludes  
10 providers departing notably from this consensus, or subject to a supervisory  
11 jurisdiction that does so. There is safety in numbers, and the possibility for  
12 consensus between many States makes it more likely and more defensible  
13 that non-conforming States will pay a price in market access. Added to this  
14 may be a price in political isolation. States playing the regulatory  
15 competition game at its hardest will not be pleased if other States are able to  
16 form a well-informed oppositional front. One may note finally that  
17 communicated consensus between States may strengthen their position even  
18 if service providers – or the Commission – do choose to litigate. The Court  
19 of Justice must itself then interpret the open norms, and a broad European  
20 consensus for a certain view is likely to carry more weight than an argument  
21 from a uniquely mono-national point of view.

**H. Collusion or democratic co-operation?**

The outcome of an oligopolistic market with high levels of communication and sanction is likely to be, in the absence of countervailing factors, coordinated behaviour<sup>368</sup>. In the context of a market for regulation it seems likely that some degree of convergence of regulation will occur, as States realize that locating their regulation within a consensus band is in their own interests, as it prevents competition between them.

In a conventional market this would be seen as undesirable. However, in a conventional market the concern is usually to maximize the welfare of consumers, and to prevent sellers from organizing to hinder that goal. In a context of regulatory competition matters change somewhat. The consumers of laws are service providers, whose welfare is a concern, but by no means the exclusive or even major concern of policy in this area. By contrast, the end consumers of the services are democratically represented in the States – the sellers of law – giving these a legitimacy that they do not have in a normal market. The situation requires more careful analysis.

In the absence of international trade rules, States can make their own trade-offs between the costs and benefits associated with opening their markets, and different levels of regulation<sup>369</sup>. Low regulation may stimulate economic activity, but bring unwelcome consequences. High regulation may serve some consumer interests, but hinder economic activity. Opening the

1 national market to foreign providers may create the risk of domestic  
2 producers locating abroad where regulation is lighter, but may also result in  
3 increased domestic competition and lower prices. All are legitimate factors  
4 to take into account.

5       However, if trade rules constrain a State to open its markets at least  
6 to some non-trivial extent – as both the Treaty the directive do – then that  
7 State loses the capacity to balance interests exclusively according to the  
8 preferences of its population<sup>370</sup>. One may hope that the joining of the trade  
9 area and the submission to the trade rule is a preference of the population, so  
10 that this is a non-issue, but in practice it is never quite so simple; populations  
11 would ideally like to be members of the trade area but not take all the  
12 consequences all of the time.

13       Giving States the capacity to co-operate and thereby gain a certain  
14 independence of migrating companies restores some balance to their policy-  
15 making capacity. If the goal is that States are able to make policy reflecting  
16 the preferences of their populations then it may be advantageous. Yet while  
17 the resulting convergence to a consensus may reflect preferences better than  
18 an unfettered race to the bottom would, it may nevertheless not be optimal.  
19 The tendency of colluding sellers is to keep prices too high, and the  
20 tendency of co-operating States, freed from pressure from the consumers of  
21 their laws, may be to undervalue the advantages of limited regulation, and



1 overvalue their own institutional interests in a strong State-administered  
2 regulatory system.

3 **I. Variable and flexible co-operation**

4 An apparently attractive aspect of the situation created by the directive is  
5 that it allows for variation and change within the overall framework of a  
6 movement towards consensus. A State that wishes to go its own regulatory  
7 path is still able to in any given area, while converging on others, provided it  
8 is prepared to accept the possible price in access and isolation. While the  
9 result of communication may be convergence, this is voluntary, and so  
10 reversible. Moreover, it need not be full convergence; the degree to which  
11 States are prepared to accept diversity is negotiable and dynamic, and may  
12 change and broaden as they come to understand each other better. Initial  
13 reactions to mutual learning may be an eagerness to agree terms, but as trust  
14 deepens States may be more and more able to accept divergent regulation.  
15 Collusion is an utterly flexible mechanism.

16 **VI. Conclusions**

17 It is a difficult empirical question, beyond the scope of this article or the  
18 expertise of its author, whether communication and co-operation between  
19 States will in fact lead to optimal regulation or how far it will diverge from

1 the optimum. However, whatever the outcomes, three *a priori* points may be  
2 made about the mechanisms involved, based on the preceding discussion:

EXT 3 Firstly, the relationship between the directive and the market for  
4 services is not what it is commonly presented to be. The  
5 conventional presentation is that the directive creates free movement;  
6 this leads to regulatory competition, which in turn may lead to  
7 agreement to Commission-led harmonisation. In fact, it is suggested  
8 that a more important sequence will be as follows: authorities  
9 communicate and learn about each other, this leads to convergence  
10 of regulation and acceptance of regulation, and as a result they open  
11 their markets to each others' providers. Limited voluntary  
12 harmonisation therefore leads to free movement, rather than free  
13 movement leading to traditional EU harmonisation.

14 Secondly, the absence of the EU or the Commission in the  
15 mechanism described is striking. While the directive envisages that  
16 the States and the Commission will together form an information  
17 network with a view to harmonisation where necessary, in fact the  
18 role of the Commission may be marginalized. If States are able to  
19 work together then they may see no need for true harmonisation, and  
20 resist the loss of autonomy and flexibility that it entails.

1 Thirdly, it is open to doubt whether an oligopolistic market for  
2 regulation is optimal, but it is worth noting that this market will be a  
3 dynamic and unstable one. The States collectively gain power as a  
4 result of co-operation, but that does not mean that actors such as  
5 firms and the Commission are entirely removed of influence. For one  
6 thing, even where there is a functioning consensus there is likely to  
7 be relative dissatisfaction in some States, who would rather locate  
8 the consensus elsewhere. Thus a role for traditional harmonization,  
9 or intervention from Brussels is not completely absent. By strategic  
10 intervention both the Commission and industry lobbies can do  
11 something to counteract a possible tendency among colluding States  
12 to over-value selected interests and ignore others.

13 In summary, trust, legislation, mutual recognition and market-making are  
14 inter-dependent. Developments in one affect all of the others. Effective  
15 legislation or policy uses this fact to achieve indirect – second order – as  
16 well as direct results. The Services Directive provides only a mildly  
17 reformed framework for substantive mutual recognition, but a greatly  
18 enhanced framework for trust and communication. It seems likely that this  
19 will contribute to the effectiveness of mutual recognition and market  
20 operation, and ultimately promote more selective, but more achievable and  
21 useful, and perhaps often voluntary, harmonisation.

## Notes

<sup>313</sup> This formulation is taken from the presentation by Prof. R. Bachmann at the *Modern Law Review* workshop on The Regulation of Trade in Services: ‘Trust, Distrust and Economic Integration’, held in London and Cambridge in June 2009. I am grateful to the participants of this workshop for discussion and comments.

<sup>314</sup> K. Nicolaidis, ‘Trusting the Poles? Creating European through Mutual Recognition’, *JEPP* 14(5) (2007), 682–698, p. 683.

<sup>315</sup> *Ibid.*

<sup>316</sup> W. Kerber and R. van den Bergh ‘Mutual recognition revisited: misunderstandings, inconsistencies and a suggested reinterpretation’ *Kyklos* 61 (2008) 447–465; G. Davies ‘Is Mutual Recognition an Alternative to Harmonisation? Lessons in Tolerance and Trade from the European Union for the WTO and other RTAs’ in: F. Ortino and L. Bartels (eds.) *Regional Trade Agreements and the WTO* (Oxford: OUP, 2006) pp. 265–280.

<sup>317</sup> G. Davies ‘Is Mutual Recognition an Alternative to Harmonisation? Lessons in Tolerance and Trade from the European Union for the WTO and other RTAs’, above.

<sup>318</sup> K. Nicolaidis, above, p. 683.

<sup>319</sup> Ibid.

<sup>320</sup> Directive 2006/123/EC of the European Parliament and of the Council on services in the Internal Market OJ (2006) L 376/76.

<sup>321</sup> Case C-55/94 *Gebhard* [1995] ECR I-4165; Case C-76/90 *Säger and Dennemeyer* [1991] ECR I-4221.

<sup>322</sup> S. Weatherill, 'Protecting the Consumer Interest in an Integrated Services Market', *Mitchell Working Paper 1/2007*, available at [http://www.law.ed.ac.uk/file\\_download/series/23\\_promotingtheconsumerinterestinanintegratedservicesmarket.pdf](http://www.law.ed.ac.uk/file_download/series/23_promotingtheconsumerinterestinanintegratedservicesmarket.pdf), 2 (last visited September 26, 2010).

<sup>323</sup> Case 279/80 *Webb* [1981] ECR 3305.

<sup>324</sup> Case C-58/98 *Corsten* [2000] ECR I-1919.

<sup>325</sup> Case 120/78 *Cassis de Dijon* [1979] ECR 649; S. Weatherill, *EU Consumer Law and Policy* (Cheltenham: Edward Elgar, 2005).

<sup>326</sup> Eg. Case C-422/01 *Skandia* [2003] ECR I-6817; Case C-281/06 *Jundt* [2007] ECR I-12231.

<sup>327</sup> See S. Weatherill, 'Protecting the Consumer Interest in an Integrated Services Market', above, pp. 12–15.

<sup>328</sup> Ibid.

<sup>329</sup> G. Davies, 'Abstractness and Concreteness in the Preliminary Reference Procedure' in: N. Nic Shuibhne (ed.) *Regulating the Internal Market*

(Cheltenham: Edward Elgar, 2006) pp. 233–236 (also available as ‘The Division of Powers between the European Court of Justice and National Courts’ on ssrn.com).

<sup>330</sup> See generally F. Snyder, ‘The Effectiveness of European Community Law: Institutions, Processes, Tools and Techniques’, *MLR*, 56(1) (1993), 19–54.

<sup>331</sup> S. Weatherill, ‘Protecting the Consumer Interest in an Integrated Services Market’, above, pp. 12–15; J. Pelkmans, ‘Deepening Services Market Integration – a Critical Assessment’, *Romanian Journal of European Affairs*, 7(4) (2007), 5–32, section 4.2 (also available on ssrn.com); B. De Witte ‘Setting the Scene: How did Services get to Bolkestein and Why?’ *Mitchell Working Paper 3/2007*, available at [http://www.law.ed.ac.uk/file\\_download/series/28\\_settingthescenehowdidservicesgettobolkesteinandwhy.pdf](http://www.law.ed.ac.uk/file_download/series/28_settingthescenehowdidservicesgettobolkesteinandwhy.pdf), 6–7 (last visited September 26, 2010).

<sup>332</sup> See S. Prechal ‘Free Movement and Procedural Requirements: Proportionality Reconsidered’, *LIEI* 35 (2008), 201–216; C. Barnard, ‘Unravelling the Services Directive’, *CMLRev*, 45 (2008), 323–394, pp. 354–356.

<sup>333</sup> Case C-224/01 *Köbler* [2003] ECR I-10239; Cases C-46 and 48/93 *Brasserie du Pecheur* [1996] ECR I-1029; Case C-129/00 *Commission v Italy* [2003] ECR I-14637.

<sup>334</sup> M. Jarvis, *Application of EC Law by National Courts: Free Movement of Goods* (Oxford: Clarendon Press, 1998), pp. 220–221.

<sup>335</sup> Eg. Case C-384/93 *Alpine Investments* [1995] ECR I-1141; Case C-134/04 *Commission v Italy* [2007] ECR I-6251; Cases C-94/04 and C-202/04 *Cipolla and Others* [2006] ECR I-11421.

<sup>336</sup> See E. T. Beller, ‘The Headscarf Affair: The Conseil d’État on the Role of Religion and Culture in French Society’, *Texas International Law Journal*, 39 (2004), 581–623; T. J. Gunn, ‘Religious Freedom and Laïcité: A Comparison of the United States and France’, *Brigham Young University Law Review*, (2004) 419–506; M. Mahlmann, ‘Religious tolerance, Pluralist Society and the Neutrality of the State: The Federal Constitutional Court’s Decision in the Headscarf Case’, *German Law Journal*, vol. 4 issue 11 (2003), 1099–1116.

<sup>337</sup> Ibid.

<sup>338</sup> See B. de Witte, ‘Setting the Scene: How did Services get to Bolkestein and Why?’, above, pp. 9–10.

<sup>339</sup> See J-M. Sun and J. Pelkmans, ‘Regulatory Competition in the Single Market’, *JCMS*, 33 (1995), 67–89.

<sup>340</sup> See F. Scharpf, ‘Economic Integration, Democracy and the Welfare State’, *JEPP*, 4 (1997), 18–36.

<sup>341</sup> K. Nicolaidis and G. Schaffer, 'Transnational Mutual Recognition Schemes: Governance without Global Government', *Law and Contemporary Problems*, 68 (2005), 263–317.

<sup>342</sup> See K. Nicolaidis, 'Trusting the Poles? Creating European through Mutual Recognition', *JEPP* 14(5) (2007), 682–698.

<sup>343</sup> See G. Davies, 'Abstractness and Concreteness in the Preliminary Reference Procedure', above, p. 232.

<sup>344</sup> There is a consensus on this. See eg. S. Weatherill, 'Protecting the Consumer Interest in an Integrated Services Market', above; C. Barnard, 'Unravelling the Services Directive', above; S. Griller 'The Services Directive: Two Steps Forward, How Many Back' in: F. Breuss, G. Fink and S. Griller *Services Liberalisation in the Internal Market* (Vienna: Springer, 2008) p. 225.

<sup>345</sup> Articles 9–15, Directive 2006/123.

<sup>346</sup> S. Weatherill, 'Protecting the Consumer Interest in an Integrated Services Market', above, pp. 12–15; J. Pelkmans, 'Deepening Services Market Integration – a Critical Assessment', above, Section 4.2; S. Griller, 'The Services Directive: Two Steps Forward, How Many Back', above.

<sup>347</sup> C. Barnard, 'Unravelling the Services Directive', above, p. 367; S. Weatherill, 'Protecting the Consumer Interest in an Integrated Services Market', above, p. 2.



<sup>348</sup> Similarly, V. Hatzopoulos, ‘Legal Aspects in Establishing the Internal Market for Services’, *College of Europe Research Paper in Law* 6/2007.

<sup>349</sup> C. Barnard, ‘Unravelling the Services Directive’, above, p. 366. Cf. the plausible argument popular on the continent that the mandatory requirements will and should be interpreted into Article 16 just as they were interpreted into the almost identically worded Article 49 EC; V. Hatzopoulos, *Legal Aspects in Establishing the Internal Market for Services*, above; J. Pelkmans, ‘Deepening Services Market Integration – a Critical Assessment’, above ; G. Davies ‘The Services Directive: Extending the Country of Origin Principle and Reforming Public Administration’, *ELRev.*, 32 (2007), 232–245, p. pp. 235.

<sup>350</sup> Case C-36/02 *Omega Spielhallen* [2004] ECR I-9609.

<sup>351</sup> Article 9(1); Article 16(1).

<sup>352</sup> Case C-55/94 *Gebhard* [1995] ECR I-4165.

<sup>353</sup> Cf. C. Barnard, ‘Unravelling the Services Directive’, above, pp. 336–339.

<sup>354</sup> See also C. Barnard, ‘Unravelling the Services Directive’, above, pp. 343–344.

<sup>355</sup> *Ibid.*, pp. 393–394.

<sup>356</sup> Article 5–8.

<sup>357</sup> See Articles 28–36. See also Articles 7 and 21.

<sup>358</sup> S. Deakin, 'Two Types of Regulatory Competition: Competitive Federalism versus Reflexive Harmonisation. A Law and Economics Perspective on Centros', *CYELS*, 2 (1999), 231–260.

<sup>359</sup> See generally, A. Ogus, 'Competition between National Legal Systems: A Contribution of Economic Analysis to Comparative Law', *ICLQ*, 45 (1999), 405–418.

<sup>360</sup> For an overview in the EU context see, C. Barnard and S. Deakin, 'Market Access and Regulatory Competition' *Jean Monnet Working Paper 09/01*, available at <http://centers.law.nyu.edu/jeanmonnet/papers/01/012701.html> (last visited .September 26, 2010)

<sup>361</sup> See eg. G. Monti, *EC Competition Law* (Cambridge University Press, 2007), pp. 308–311.

<sup>362</sup> See A. Ogus, 'Competition between National Legal Systems: A Contribution of Economic Analysis to Comparative Law', above. The definition of dominance is from Case 85/76 *Hoffman La Roche* [1979] ECR 461. See also G. Monti, 'The Concept of Dominance', *European Competition Journal*, 2 (2006), 31–52.

<sup>363</sup> See C. Barnard and S. Deakin, 'Market Access and Regulatory Competition', above.

<sup>364</sup> See A. Jones and B. Sufrin, *EC Competition Law* 3<sup>rd</sup> ed. (Oxford: OUP, 2008), pp. 871–873.

<sup>365</sup> See Articles 7, 21, 28–36.

<sup>366</sup> [Chapter II](#) of the Services Directive.

<sup>367</sup> See Articles 28(2), 32(2), 34.

<sup>368</sup> See footnote [n 52](#) above.

<sup>369</sup> See J-M. Sun and J. Pelkmans ‘Regulatory Competition in the Single Market’, above; R. van den Bergh, ‘Towards an Institutional Legal Framework for Regulatory Competition in Europe’, *Kyklos* 53 (2000), 435–466; M. Trebilcock and R. Howse, ‘Trade Liberalisation and Regulatory Diversity: Reconciling Competitive Markets with Competitive Politics’, *European Journal of Law and Economics*, 6 (1998), 5–37; J. Trachtman, ‘International Regulatory Competition, Externalisation, and Jurisdiction’, *Harvard International Law Journal*, 34 (1993), 47–104.

<sup>370</sup> *Ibid.*